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Regarding

Long-Term Care and Medicaid: Spiraling Costs and the Need for Reform

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Good morning, Mr. Chairman and Members of the Subcommittee. My name is Barbara Stucki. Over the past 12 years, I have been conducting research on private sector financing for long-term care. I currently manage the Use Your Home to Stay at Home Initiative for the National Council on the Aging (NCOA). I would like to thank you for providing the NCOA the opportunity to testify about the potential of using home equity to help better balance public and private funding for long-term care and to respond more rapidly to consumer preferences for "aging in place."

As the population ages and the pressure on state Medicaid budgets rises, it becomes increasingly important to find effective ways to improve our long-term care financing system. Funding the growing demand for long-term care is a major national challenge. The NCOA has recently completed a new study, funded by CMS and the Robert Wood Johnson Foundation, that provides compelling evidence that reverse mortgages could significantly increase the funds available to pay for home and community-based long-term care.

With appropriate incentives, additional educational efforts and strong consumer protections, we believe that millions of older homeowners could benefit from using these loans to continue to live at home. Voluntary use of reverse mortgages could pay for many years of home and community services, and help postpone the need for assistance from Medicaid.

Reverse Mortgages – A New Financing Option for Aging in Place

Most older Americans would prefer to "age in place" in their own homes. The high proportion of long-term care paid by government, however, suggests that few seniors can afford to pay these costs for very long. One of the paradoxes of our current long-term care system is that impaired older Americans are struggling to live at home at a time when they own more than $2 trillion in untapped housing wealth. Home ownership is high among seniors (82%), even among the those at advanced ages (75 and older - 78%). Many have accumulated substantial amounts of home equity, including families whose other retirement resources may be very modest. Over half the net worth of seniors is currently illiquid in their homes and other real estate.

Policy discussions on long-term care financing have largely ignored home equity as a potential source of private financing for in-home services and supports. This situation arose, in part, because older homeowners have had few options to liquidate housing wealth. Many retirees cannot get a conventional mortgage or home equity loan because they do not have enough income to make monthly loan payments. The development of reverse mortgages in the last 15 years offers a new way for older Americans to "use their home to stay at home" by tapping a portion of their home equity.

In the United States, reverse mortgages are the principal financial instruments available to seniors who want to convert some of their home equity into cash. Reverse mortgages can give older homeowners the funds they need to pay for long-term care and other expenses, while allowing them to continue living in their own homes. These types of loans are called "reverse" mortgages because the lender makes payments to the homeowner. Since the loan is based on the equity in the home, lenders do not consider the borrower's income, or credit and medical history in determining eligibility for a reverse mortgage. The Department of Housing and Urban Development (HUD) Home Equity Conversion Mortgage (HECM) program is the oldest and most popular reverse mortgage product. Currently, HECMs represent about 90 percent of all the reverse mortgages in the market.

The amount that a homeowner can borrow is based primarily on the age of the youngest homeowner, the value of the home, and the current interest rate. Older owners (because of their limited life expectancy) and those with more expensive homes are able to get higher loan amounts. Borrowers can select to receive payments as a lump sum, line of credit, fixed monthly payment (for up to life), or a combination of payment options. Proceeds from a reverse mortgage are tax-free, and borrowers can use these funds for any purpose. Reverse mortgage borrowers do not need to make any payments for as long as they (or in the case of couples, the last living borrower) continue to live in the home as their primary residence. When the last borrower permanently moves or dies, the loan becomes due.

There are several key protections in place for people who decide to take out a reverse mortgage. All reverse mortgages are non-recourse loans, which mean that the borrower or heirs never owe more that the value of the home at the time of sale or repayment of the loan. All borrowers who apply for any reverse mortgage must first receive independent counseling before they complete the loan application. In addition, Federal Truth-in-Lending law requires that reverse mortgage lenders disclose the projected average annual cost of the loan. Borrowers can cancel the loan for any reason within three business days after closing. To protect impaired older homeowners, additional standards may be required. Since these loans can be used for any purpose, there are currently no formal standards used by the mortgage industry when marketing this product.

By using a reverse mortgage to liquidate a portion of their housing wealth, seniors do not have to move or relinquish control over their most important asset. Since reverse mortgages only allow borrowers to tap a portion of their home equity, there may be funds left over after paying off the loan to support the spouse or cover assisted living or other facility care. Borrowers or their heirs can also benefit from any appreciation in the value of the home over time. Spouses are protected since they will never owe more than the value of their home

Expanding Financing for Aging in Place

Greater focus on home equity can add an important new element to the long-term care financing debate. Based on our analysis of the 2000 Health and Retirement Study, NCOA estimates that almost half of households age 62 and older - 13.2 million - are candidates for using a reverse mortgage to pay for long-term care at home (defined as being able to receive a minimum of $20,000 from this loan). The amount of funds that could become available if these older homeowners liquidated a portion of their home equity is substantial. By calculating the amount of funds that could be available from reverse mortgages for individual households, we estimate that these loans could increase private sector funding for in-home services and supports in total by $953 billion.

<u>Target populations</u> - Reverse mortgages could play an important role in reducing the likelihood that older Americans will deplete their financial resources paying for long-term care. This could be especially important to older households with moderate incomes whose resources, while adequate for daily needs, are inadequate to handle more than a few years of home care payments (averaging about $27,000 per year in 2000). This group is often referred to as “tweeners.”

The NCOA study estimates that among candidate households for a reverse mortgage, there are about 3.3 million households who are at financial risk for spending-down if they need home care

(Table 1 – Spend-down risk). These moderate-income elders could tap almost $63,000 on average with a reverse mortgage. Most of these households (66 percent) consist of unmarried homeowners.

Table 1. Distribution of home ownership by market segment

	Total households age 62+	Total owner households	% total households	Candidate households for using a RM for LTC	% total households	% owner households
Medicaid beneficiary	2,537,000	1,058,000	41.7%	437,000	17.2%	41.3%
High risk Medicaid	4,444,000	2,927,000	65.9%	1,403,000	31.6%	47.9%
Spend-down risk	7,331,000	5,449,000	74.3%	3,321,000	45.3%	60.9%
Low Medicaid risk	13,083,000	11,642,000	89.0%	8,034,000	61.4%	69.0%
Total	27,397,000	21,077,000		13,196,000		

Source: NCOA calculations based on data from the 2000 Health and Retirement Study.

About 0.4 million candidate households are Medicaid beneficiaries. On average, these homeowners who live in the community could receive a HECM loan worth $51,229. At current interest rates, these funds would enable them to make monthly withdrawals of $1,465 from a HECM creditline for about three years, or monthly withdrawals of about $470 for ten years (Table 2). Only about one in three of these candidate households are married. Though Medicaid beneficiaries may be receiving home and community services, additional cash from reverse mortgages can help cover unmet needs while providing greater choice and control over services.

High Medicaid risk households have very limited income and assets. These financially vulnerable elders could access a lump sum or line of credit worth on average $55,085 from a HECM loan (Table 2). With limited financial resources, they would quickly qualify for public assistance if they needed long-term care. Since the home is a protected asset under Medicaid eligibility rules, the motivation to access home equity among this group is likely to be small. However, a reverse mortgage could be very important to support family caregiving, since most (69 percent) homeowners in this group are married. These loans could also help this group of elders avoid institutionalization. These older homeowners may not be able to afford an assisted living facility, and there are long waiting lists for HCBS waivers and subsidized housing.

Table 2. Amount of potential HECM funds, by Medicaid risk level

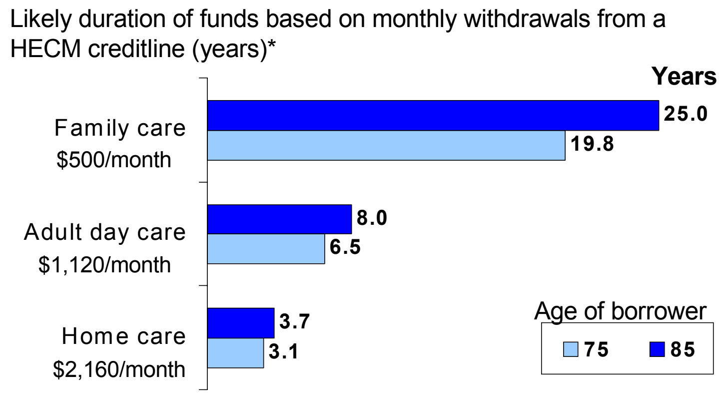
	Average potential cash or creditline from a HECM loan	Monthly withdrawals by estimated duration of funds		
		3 years	5 years	10 years
Medicaid beneficiary	$51,229	$1,465	$895	$470
High risk Medicaid	$55,085	$1,575	$964	$506
Spend-down risk	$62,800	$1,798	$1,100	$577
Low Medicaid risk	$80,130	$2,290	$1,403	$737
Total	$72,128			

NCOA calculation using the AARP reverse mortgage calculator and a creditline interest rate of 4.35%.

Low Medicaid risk households include homeowners who can afford to pay for daily home care for at least two years (single households) or four years (married households). The average reverse mortgage loan value among this group is $80,130. With greater access to liquid assets, more affluent elders might be reluctant to tap home equity to pay directly for in-home services and supports. Demand for reverse mortgages among this group may instead emerge from a desire to protect their wealth and leverage their resources through private long-term insurance. About half (53 percent) of Low Medicaid risk households consist of couples.

Potential savings to Medicaid - For many middle-income seniors on fixed incomes, a reverse mortgage can be a critical resource to help avoid a financial crisis. This loan could pay for over three years of daily home care visits or eight years of adult day care for a homeowner age 85 with a median priced home (Figure 1).

Figure 1. Duration of funds to pay for home and community care from a HECM creditline



*HECM estimate based on median home value in 2004 ($122,790) and an annual creditline interest rate of 5.46%. Source: NCOA analysis using the AARP reverse mortgage calculator.

Payments from a reverse mortgage can help reduce dependence on Medicaid and reduce the risk of institutionalization. Increased use of this financial option for long-term care could result in savings to Medicaid ranging from about $3.3 to almost $5 billion annually in 2010, depending on market penetration rates increasing from 4 percent to 25 percent of older homeowners. This represents 6 to 9 percent of the total projected annual Medicaid expenditures, including nursing home care. These reductions result from the additional income available to borrowers that would delay eligibility for Medicaid. When contrasted with the amount Medicaid is expected to spend on seniors for long-term care services at home in 2010 ($14.9 billion, based on estimates by the Congressional Budget Office), $3.3 to $5 billion in reverse mortgage funds could be a substantial additional resource for people who need assistance to age in place.

Rebalancing the System

Many states and communities are developing creative ways to support older people who want to age in place. The impetus for these efforts reflects the convergence of two important goals: meeting consumers' desire to stay at home while controlling the rising cost of long-term care. Despite local and national efforts to promote aging in place, however, the pace of change has been slow. Reverse mortgages could provide an immediate source of funds to stimulate and enhance government efforts to rebalance our country's long-term care system toward increased access to home and community services.

For many older Americans, the home is their most valuable asset. Many are reluctant to touch this resource until their other financial resources and family caregivers are exhausted. This strategy can increase the risk that seniors will not have enough money to maintain their independence or the home they cherish. When they reach a crisis point, older homeowners often tap home equity by selling the home. Housing wealth, however, can be more than just a last resort. Reverse mortgages can pay for preventive measures such as home modifications, expenses of family caregivers, as well as day-to-day support that can reduce the risk of institutionalization.

Reverse mortgages can also strengthen existing financial plans by filling in gaps (such as the cost of replacing a furnace) and help impaired elders manage cash flow to cope with the uncertainties that often come with a chronic health condition. Tapping home equity can give seniors who have not been able to plan ahead through conventional means (such as long-term care insurance) new options for maintaining independence and choice if they need help at home. These loans give seniors more flexibility in managing their financial assets over time.

Reverse mortgages hold considerable promise to help impaired, older homeowners pay for the services they need to continue to live at home. Using home equity to pay for long-term care insurance is more problematic. Based on our analysis, this approach will likely be an option for only a very small number of older homeowners. It can be very costly for borrowers since they would be paying both insurance premiums and interest on the loan for many years. In addition, borrowers who use the proceeds of their loan to pay their premiums face the risk of their coverage lapsing if they run out of loan funds before they need care. An alternate approach would be to use the loan proceeds to increase the amount of home and community care that homeowners fund out-of-pocket. This could make private insurance more affordable because elders could buy more limited long-term care insurance coverage. Current policyholders could also use a reverse mortgage for additional funds to avoid lapsing their existing coverage.

Need for Government Action

Additional cash from reverse mortgages offer impaired elders the flexibility and choice that can enhance aging with independence and dignity. This financing option should appeal to a greater number of older Americans and can encourage increased personal responsibility. But the strong feelings that today's seniors have about their homes suggest that this approach will not be a quick or easy solution to our nation's long-term care financing problem. Few older homeowners are currently interested in using a reverse mortgage due to a reluctance to use home equity and a lack of understanding about how these loans work. Without additional education and strong incentives to support family decisions regarding the use of home equity, the actual number of older homeowners who take out a loan to pay for help at home is likely to be small.

Impaired, older homeowners need additional information to evaluate the appropriateness of taking out a reverse mortgage. Consumer outreach can help older homeowners and their families understand the benefits and limitations of using a reverse mortgage to "age in place." Greater awareness of the potential of reverse mortgages will help seniors and the people who advise them consider this product as a mainstream option for long-term care financing.

Government, non-profit organizations, and industry could work together to develop educational campaigns targeting consumers, service providers in the community, and senior advisors. The state and federal governments should also include the use of reverse mortgages in their educational efforts on long-term care. The NCOA study found that adult children are far more comfortable with the idea of using home equity than their parents. Conversations about reverse mortgages could serve as an important catalyst to help families plan for their long-term care needs. A broad public education campaign would be of enormous value.

There are a number of other things Congress and CMS can do to address several consumer concerns that currently limit the use of home equity.

1. <u>Remove government barriers that hinder access to reverse mortgages</u>. Since reverse mortgages must be in first lien position, state use of Medicaid liens can be a deterrent to promoting home equity to pay for long-term care. Fannie Mae requires that any outstanding

liens against the property must be paid in full at the loan closing. If a state places a lien on a home when one spouse goes on Medicaid, the community spouse will not be eligible to apply for a reverse mortgage. CMS should clarify Medicaid rules to ensure that Medicaid liens will be released if the surviving spouse wants to sell or refinance the property, or obtain a reverse mortgage.

2. Increase the funds available from home equity by reducing reverse mortgage loan costs. In 2000, Rep. LaFalce included a provision in the American Homeownership and Economic Opportunity Act to amend Section 255 of the National Housing Act to waive the up front mortgage insurance premium (usually 2 percent) for a reverse mortgage used to purchase private long-term care insurance. While we support the intent of the law, which was to make reverse mortgages more available for long-term care needs, it unduly limits consumers' options by requiring participants to use the entire payment exclusively for insurance. A far more desirable and appropriate use would be for long-term services themselves. Congress should amend or repeal the provision and instead waive the premium for borrowers who use a reverse mortgage primarily to pay for such services and supports. The law could also be expanded to waive the premium for borrowers independently assessed to need long-term care.

3. Stretch loan funds to promote aging in place for as long as possible. The Center for Medicare and Medicaid Services (CMS) could enable Medicaid beneficiaries to use funds from a reverse mortgage to purchase non-covered home- and community-based services. Other alternatives include developing Medicaid buy-in programs with home equity or enabling states to target older homeowners at risk for Medicaid.

   CMS could allow states to experiment with programs that target seniors who are ineligible to qualify for home and community services under a Medicaid waiver program because they have not yet met the nursing home level of care criteria. Incentives could be developed to use home equity to pay for earlier interventions that support aging in place and reduce the risk of institutionalization.

4. Reduce the risk of impoverishment and protect the spouse. Congress is likely this year to consider making long-term care "public-private partnership" programs more available to consumers in many states. Four states – California, Connecticut, Indiana and New York – now use this approach to promote the purchase of long-term care insurance by protecting purchasers' resources from the Medicaid eligibility asset test. A similar approach should be used to promote the use of reverse mortgages. Borrowers who use a certain portion of the equity in their homes to pay for long-term care could receive more favorable treatment under Medicaid's resource rules.

Government incentives for reverse mortgages may encourage impaired seniors to access home equity sooner and reduce the need to recoup public long-term care expenses through estate recovery. Many of the consumer concerns that motivate the use of Medicaid estate planning, such as loss of control of assets and a desire to leave a bequest, can be addressed through reverse mortgages. By providing cash, these loans enable impaired seniors to control the type and amount of services they receive. Since a reverse mortgage only taps a portion of home equity, it is possible that there will be funds left for heirs after the loan is paid.

Use of Reverse Mortgages Must be Voluntary

In developing a roadmap for the future, it will be important to ensure that the desire for government savings is balanced with the need to expand the ability of seniors to continue to live at home. As we look to the future, it will be important to find ways to improve the functioning of the reverse mortgage market in such a way that both consumers and government benefit.

NCOA opposes mandatory use of reverse mortgages. We believe that government incentives will increase demand for these types of loans while still preserving consumer choice and autonomy. Incentivizing the use of reverse mortgages also offers a better way to respond to rising demand and fiscal constraints. Offering incentives to increase the use of home equity could open new avenues for public and private resources to complement one another in meeting the changing needs of impaired seniors who live at home.

Other Medicaid Reforms

There are a wide variety of other Medicaid long-term care reforms that would promote greater independence, dignity and choice, while reducing per capita costs. For example, NCOA supports:

- The President's "Money Follows the Person" rebalancing proposal. Under the proposal, for persons transitioning out of institutions, the federal government would cover the entire first year of costs for Medicaid home and community-based waiver services in select states;
- Permitting states to provide Medicaid home and community-based services (HCBS) under a state plan amendment, rather than having to go through an often burdensome waiver process;
- Giving states more flexibility by eliminating the current requirement that Medicaid HCBS coverage be linked with a need for nursing home level of care;
- Recognizing under the Medicaid eligibility asset test that persons in need of HCBS must pay for housing, food, clothing, utilities, and transportation, while nursing home residents do not incur these costs;
- Leveling the playing field on protections for spouses since, under current law, spousal impoverishment protections are mandatory for nursing facility services, optional for HCBS waiver programs, and prohibited under the Medicaid personal care program;
- Permitting states to include Medicare savings in their Medicaid HCBS waiver budget neutrality calculations;
- Reducing barriers for states to provide consumers with greater opportunities to choose consumer directed models of Medicaid home and community services, such as cash and counseling; and
- Permitting Medicaid recipients in need of long-term care to receive community attendant services as an alternative to institutional care.

In summary, funding the growing demand for long-term care is a major national challenge. Policymakers should leverage limited housing assets by promoting reverse mortgages as part of a public-private effort to help fund services for aging in place. With additional education and strong consumer protections, this strategy can open new possibilities for a more coordinated financial approach that can reduce the risk of institutionalization and enhance quality of life for older Americans.